

Message Text

CONFIDENTIAL

PAGE 01 OTTAWA 01232 01 OF 03 110029Z
ACTION EUR-12

INFO OCT-01 ISO-00 SOE-02 AID-05 CEA-01 CIAE-00
COME-00 DODE-00 EB-08 DOE-11 H-01 INR-10 INT-05
L-03 NSAE-00 OMB-01 PM-05 OES-07 SP-02 SS-15
STR-07 TRSE-00 ACDA-12 NSCE-00 SSO-00 USIE-00
INRE-00 /108 W

-----062626 110045Z /63

O 102345Z MAR 78
FM AMEMBASSY OTTAWA
TO SECSTATE WASHDC IMMEDIATE 6610

C O N F I D E N T I A L SECTION 01 OF 03 OTTAWA 01232

DEPT. PASS DOE FOR FERC COMMISSIONER SMITH, LES GOLDMAN
AND JOHN ADGER

E.O. 11652: GDS
TAGS: ENRG, CA
SUBJECT: CAPITAL COST OF NORTHERN GAS PIPELINE

REFS: A. STATE 60183, B. STATE 62084

1. EMBASSY DATED AND DELIVERED LETTER FROM FERC
COMMISSIONER SMITH TO NEB'S EDGE (REF A) MARCH 10.
LETTER, ALONG WITH COPY FOR NEB CHAIRMAN STABBACK, LEFT
WITH STABBACK FOR TRANSMISSION TO EDGE. LETTER
ENCLOSED PROPOSED ADDENDUM TO ANNEX III OF BILATERAL
AGREEMENT (REF B), AS REVISED IN PLACKE TELECONS WITH
DOE'S ADGER AND STATE'S BOSWORTH. TEXTS FOLLOW.

2. "DEAR GEOFF:

"AT YOUR DIRECTION, WE WERE PROVIDED A COPY OF THE
FOOTHILLS PIPELINES (YUKON) LTD. LETTER OF MARCH 3,
1978, WHICH DISCUSSES ITS CAPITAL COST ESTIMATES FOR
THE PIPELINE IN CANADA, WITH A 56-INCH, 1080 PSIG SECTION
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 OTTAWA 01232 01 OF 03 110029Z

BETWEEN WHITEHORSE IN THE YUKON TERRITORY AND THE
BIFURCATION POINT NEAR CAROLINE JUNCTION IN ALBERTA.
FOOTHILLS HAS RE-ESTIMATED THAT THE ADDITIONAL COSTS
OF A 56-INCH SYSTEM OVER THOSE OF THE 54-INCH SYSTEM
CONTAINED IN ANNEX III OF THE AGREEMENT ON PRINCIPLES
BETWEEN THE U.S. AND CANADA ARE DOLS 91 MILLION IN
ESCALATED DOLLARS. THIS FIGURE COMPARES TO ESTIMATE OF DOLS 94

MILLION, WHICH INCLUDED AN ADJUSTMENT OF DOLS 18 MILLION (DOLS 24.2 MILLION IN CONSTANT 1976 DOLLARS) TO THE FILED COST ESTIMATES WHICH ARE SET OUT IN ANNEX III. THE FIGURES AGREED TO IN ANNEX III SHOULD FORM THE BASIS FOR ESTIMATING COSTS FOR THE 56-INCH SYSTEM.

"THE PRESENT FILING SHOWS A COST INCREASE IN CONSTANT 1976 DOLLARS FOR THE 56-INCH ALTERNATIVE OVER THE 54.3 MILLION OR DOLS 24 MILLION MORE THAN FOOTHILLS' FEBRUARY 27, 1978, ESTIMATE OF DOLS 10.3 MILLION. FOOT-HILLS HAS ADJUSTED ITS 56-INCH COST ESTIMATES TO YIELD ESSENTIALLY THE SAME INCREMENTAL AMOUNT THEY WERE WILLING TO ACCEPT ON FEBRUARY 27, 1978, WHICH IT KNEW AT THE TIME INCLUDED THE DOLS 24.2 MILLION CORRECTION IN FILED BASE CASE NUMBERS.

"MR. RUTHERFORD'S MARCH 3 LETTER TO YOU INDICATES THAT FOOTHILLS IS PREPARED TO DEMONSTRATE THE REASONABLENESS OF THE UNIT INCREMENTAL COSTS UTILIZED IN ARRIVING AT ITS NEWEST ESTIMATE. WE WOULD WELCOME SUCH A DEMONSTRATION, PROVIDED THE DEMONSTRATION ALSO INCLUDES A GENUINE EFFORT TO RESOLVE THE DIFFERENCES BETWEEN OUR RESPECTIVE COST ESTIMATES.

"THE U.S. ESTIMATES WERE DERIVED FROM BASE CASE (48-INCH, CONFIDENTIAL

CONFIDENTIAL

PAGE 03 OTTAWA 01232 01 OF 03 110029Z

1260 PSIG) DATA SUPPLIED BY FOOTHILLS, ET AL. UNFORTUNATELY, THE DATA FROM THE THREE INDIVIDUAL FOOTHILLS COMPANIES WAS NOT INTERNALLY CONSISTENT WITH REGARD TO FORMAT, NOR WAS IT IN THE FORM WE REQUESTED. AS A CONSEQUENCE, IN OUR ATTEMPT TO OBTAIN COST ESTIMATES FOR ALL CONSTRUCTION COST ITEMS THAT WOULD VARY WITH A CHANGE IN PIPE SIZE (I.E., PIPE, DITCHING, WELDING, SWAMP WEIGHTS, ETC.), IT WAS SOMETIMES NECESSARY TO USE NUMBERS FROM ONLY ONE COMPANY. THEREFORE, WE ALMOST CERTAINLY DID NOT RECONSTRUCT THE BASE CASE NUMBERS EXACTLY AS USED BY THE INDIVIDUAL COMPANIES. WE WERE ALSO WORKING UNDER SEVERE TIME RESTRICTIONS WHICH COULD HAVE LED TO ERRORS IN INTERPRETATION AND RECONSTRUCTION.

"WE ARE NOT NECESSARILY BOUND TO OUR COST ESTIMATES AND ARE WILLING TO ATTEMPT TO RESOLVE ANY DIFFERENCES. WHAT WE DESIRE ARE ESTIMATES THAT ARE DEMONSTRABLY REASONABLE AND LOGICAL. SINCE OUR NUMBERS ONLY DIFFER FROM THE APPLICANT'S LATEST ESTIMATES BY ABOUT DOLS 19 MILLION (IN 1976 DOLLARS), WE FEEL THAT THE CHANCES OF RESOLVING DIFFERENCES IN COST ESTIMATES ARE GOOD. HOWEVER, WE ARE UNABLE TO JUSTIFY FOOTHILLS' LATEST

COST ESTIMATES BASED ON THE BREAKDOWN OF COST IN THEIR
DETAILED ANALYSIS OF INCREMENTAL CAPITAL COSTS (1976
DOLLARS) INCLUDED IN THEIR MARCH 3, 1978, LETTER.
WE REGARD THE COMPANY'S TABLE AS ESSENTIALLY A SUMMARY,
NOT A DETAILED ESTIMATE.

"WHILE IT IS REASONABLY EASY TO ESTIMATE PIPE COSTS,
WE DO NOT HAVE THE CAPABILITY OF ESTIMATING PIPE
INSTALLATION COSTS WITHOUT BREAKING SUCH COSTS DOWN
INTO THEIR COMPONENT PARTS. FOR INSTANCE, WE ARE

CONFIDENTIAL

NNN

CONFIDENTIAL

PAGE 01 OTTAWA 01232 02 OF 03 110029Z

ACTION EUR-12

INFO OCT-01 ISO-00 SOE-02 AID-05 CEA-01 CIAE-00
COME-00 DODE-00 EB-08 DOE-11 H-01 INR-10 INT-05
L-03 NSAE-00 OMB-01 PM-05 OES-07 SP-02 SS-15
STR-07 TRSE-00 ACDA-12 NSCE-00 SSO-00 USIE-00
INRE-00 /108 W

-----062632 110044Z /63

O 102345Z MAR 78

FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC IMMEDIATE 6611

C O N F I D E N T I A L SECTION 02 OF 03 OTTAWA 01232

UNABLE TO UNDERSTAND WHY INSTALLATION COST INCREASES
ARE 50 PERCENT OF MATERIAL COST INCREASES IN ALBERTA,
BUT OVER 200 PERCENT OF MATERIAL COST INCREASES IN BRITISH
COLUMBIA, AND AT THIS JUNCTURE ARE LEFT TO SPECULATE ON
DIFFERENCES IN TERRAIN.

"TO ENABLE US TO EVALUATE THE BASIS FOR COST DIFFERENCES,
WE FEEL IT WOULD BE NECESSARY TO BREAK DOWN THE APPLICANTS'
BASE CASE COST ESTIMATES INTO SUCH INDIVIDUAL COST
ITEMS AS MILL COSTS OF PIPE, PIPE TRANSPORTATION TO
RAIL TERMINALS, TRANSPORTATION TO DISTRIBUTION POINTS,
DOUBLE JOINTING, STRINGING, DITCHING, WELDING, INSPECTION,
COATING, SWAMP AND RIVER WEIGHTS, LAYING AND BACKFILLING,
ROAD AND RIVER CROSSINGS, VALVES AND FITTINGS, COMPRESSOR
STATIONS, OTHER TRANSPORTATION COSTS, AND SUPPORT COSTS.
FROM THESE, INDEPENDENT JUDGMENTS CAN BE MADE WHICH
WILL FACILITATE RESOLUTION OF DIFFERENCES IN THE
ESTIMATED COST OF CONSTRUCTING A 56-INCH LINE.

"WE ARE PREPARED TO ATTEMPT TO RECONCILE COST DIFFERENCES ON THE ABOVE BASIS. WE WERE PREPARED TO DO SO AT THE FEBRUARY 27, 1978, MEETING IN CALGARY, ALBERTA. AT THAT TIME FOOTHILLS DID NOT INDICATE A WILLINGNESS TO CONFIDENTIAL

CONFIDENTIAL

PAGE 02 OTTAWA 01232 02 OF 03 110029Z

GO INTO THE DETAIL WE THINK WILL BE NECESSARY TO REACH A THOROUGH UNDERSTANDING OF HOW THE COST ESTIMATES WERE OBTAINED.

"TO FACILITATE REACHING AN AGREEMENT ON COSTS, IT MIGHT BE HELPFUL FOR OUR TECHNICAL PERSONNEL TO MEET INFORMALLY WITH ENGINEERS FROM EACH COMPANY, SOLELY FOR THE PURPOSES OF AGREEING TO THE ANNEX III 56-INCH ADDENDUM. THIS WOULD ALLOW US TO RECONSTRUCT PRECISELY THE BASE CASE NUMBERS AND TO DETERMINE THE SCALING FACTORS EACH APPLICANT USED IN ARRIVING AT THEIR RESPECTIVE INCREMENTAL COST ESTIMATES. WE FEEL THAT IT IS LIKELY SUCH A REVIEW WOULD PRODUCE AGREEMENT. HOWEVER, THIS MIGHT TAKE CONSIDERABLE TIME.

"ON THE OTHER HAND, WE RECOGNIZE THAT THE PRESENT DIFFERENCE BETWEEN OUR RESPECTIVE TOTALS IS WELL WITHIN THE LIKELY ESTIMATION ERROR, AND THE FIGURES MAY PROVE IMPERVIOUS TO FURTHER REFINEMENT. CONSEQUENTLY, WE WOULD BE WILLING TO ACCEPT THE ESTIMATED CAPITAL COSTS CONTAINED IN FOOTHILLS' MARCH 3 LETTER AS APPROVED FILED CAPITAL COSTS APPLICABLE TO THE AGREEMENT AS SET FORTH IN ANNEX III OF THE AGREEMENT BETWEEN THE U.S. AND CANADA ON PRINCIPLES APPLICABLE TO A NORTHERN NATURAL GAS PIPELINE, CONTINGENT UPON WRITTEN AGREEMENT THAT SUCH COSTS INCLUDE ALL NORMAL PIPELINE CAPITAL COSTS INCURRED AND PERMITTED TO BE RECOVERED IN CANADA, INCLUDING ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC), REGULATORY COSTS, ETC., EXCEPT AS SPECIFICALLY EXCLUDED IN THE AGREEMENT (I.E., WORKING CAPITAL; PROPERTY TAXES; DIRECT CHARGES FOR ROAD MAINTENANCE; AND INCREASES IN COSTS OR DELAYS CAUSED BY ACTIONS ATTRIBUTABLE TO U.S. SHIPPERS, RELATED U.S. PIPELINE CONFIDENTIAL

CONFIDENTIAL

PAGE 03 OTTAWA 01232 02 OF 03 110029Z

COMPANIES, ALASKAN PRODUCERS, PRUDHOE BAY DELIVERABILITY, CONDITIONING PLANT CONSTRUCTION, THE UNITED STATES, OR STATE GOVERNMENTS). WE SHOULD ALSO CLARIFY THAT THE CAPITAL COST ESTIMATES IN ANNEX III FOR ZONES 1-9 ARE FOR AN INITIAL THROUGHPUT CAPACITY OF 2.4 BILLION

CUBIC FEET PER DAY.

"WE ARE SPECIFICALLY CONCERNED THAT THE MONITORING COSTS CHARGED TO THE PIPELINE BY THE NORTHERN PIPELINE AGENCY ARE INCLUDED IN FOOTHILLS' ESTIMATES. OUR INTERPRETATION IS THAT ALL NORMAL PIPELINE COSTS NOT SPECIFICALLY EXCLUDED BY THE AGREEMENT ARE INCLUDED IN FILED COSTS; THUS, MONITORING COSTS ASSOCIATED WITH CONSTRUCTION OF THE PIPELINE FACILITIES SHOULD BE INCLUDED IN FOOTHILLS' MARCH 3 FIGURES. HOWEVER, TO PREVENT POSSIBLE MISINTERPRETATION OR DISAGREEMENT, WE FEEL THAT AN ADDENDUM TO ANNEX III SHOULD SPECIFY THAT THE ESTIMATED FILED CAPITAL COSTS INCLUDE THE PIPELINE MONITORING COSTS INCURRED AS THE RESULT OF SECTION 29 OF THE ACT ESTABLISHING THE NORTHERN PIPELINE AGENCY. ACCORDINGLY, I AM ENCLOSING THE DRAFT OF SUCH AN ADDENDUM AND WOULD APPRECIATE RECEIVING YOUR REACTION TO IT.

"THERE ARE SEVERAL TECHNICAL POINTS ABOUT THIS APPROACH THAT WOULD NEED TO BE WORKED OUT IN MORE DETAIL IN THE FUTURE. MONITORING COSTS INCURRED DURING THE CONSTRUCTION PERIOD WOULD BE CONSIDERED A PART OF THE CONSTRUCTION COSTS OF THE PROJECT AND WOULD BE CAPITALIZED UNTIL RECOVERY COMMENCED THROUGH THE LEVYING OF RATES ON THE SHIPPERS. THE ALLOWANCE FOR FUNDS UTILIZED IN PAYING THESE COSTS DURING THE CONSTRUCTION PERIOD WOULD BE AT THE SAME RATE AND ON THE SAME BASIS AS THE ALLOWANCE FOR OTHER COSTS CAPITALIZED DURING THE PERIOD.

CONFIDENTIAL

NNN

CONFIDENTIAL

PAGE 01 OTTAWA 01232 03 OF 03 110030Z
ACTION EUR-12

INFO OCT-01 ISO-00 SOE-02 AID-05 CEA-01 CIAE-00
COME-00 DODE-00 EB-08 DOE-11 H-01 INR-10 INT-05
L-03 NSAE-00 OMB-01 PM-05 OES-07 SP-02 SS-15
STR-07 TRSE-00 ACDA-12 NSCE-00 SSO-00 USIE-00
INRE-00 /108 W

-----062637 110043Z /63

O 112345Z MAR 78

FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC IMMEDIATE 6612

C O N F I D E N T I A L SECTION 03 OF 03 OTTAWA 01232

INSOFAR AS THE ALLOCATION OF THESE MONITORING COSTS TO THE VARIOUS ZONES, THOSE COSTS THAT ARE DIRECTLY ASSIGNABLE SHOULD BE SO ASSIGNED; THE BASES FOR ALLOCATING THE OTHER COSTS SHOULD BE EXPLAINED AND JUSTIFIED. ADDITIONALLY, ANNEX III NOTES THAT THE ACTUAL CAPITAL COSTS, FOR PURPOSES OF THIS ANNEX, WILL BE THE BOOKED COST AS OF THE DATE 'LEAVE TO OPEN' IS GRANTED, PLUS AMOUNTS STILL OUTSTANDING, TO BE ACCRUED ON A BASIS TO BE APPROVED BY THE NATIONAL ENERGY BOARD.

"THE LIFE OF THE MONITORING AGENCY IS TO EXTEND UNTIL ONE YEAR AFTER 'LEAVE TO OPEN' IS GRANTED, AND IT WOULD PRESUMABLY BE CHARGING COSTS TO THE PIPELINE DURING THAT YEAR. NO DOUBT A MUTUALLY SATISFACTORY ARRANGEMENT COULD BE WORKED OUT ON THIS POINT ALSO.

"IF AGREEMENT CANNOT BE REACHED ON AN ADDENDUM TO ANNEX III STATING THAT THE MONITORING COSTS ARE INCLUDED IN THE FILED CAPITAL COSTS PROVIDED BY FOOTHILLS IN THEIR MARCH 3 LETTER TO YOU, THEN WE WOULD FEEL COMPELLED TO REQUEST CONSULTATION BETWEEN THE TWO COUNTRIES PURSUANT TO SECTION 11 OF THE AGREEMENT ON CONFIDENTIAL

CONFIDENTIAL

PAGE 02 OTTAWA 01232 03 OF 03 110030Z

PRINCIPLES. IF OUR UNDERSTANDING CANNOT BE CONFIRMED THAT THE MONITORING COSTS ARE INCLUDED IN 'ACTUAL CAPITAL COSTS, EXCLUDING ONLY WORKING CAPITAL, PROPERTY TAXES, AND DIRECT CHARGES FOR ROAD MAINTENANCE OF UP TO DOLS 30 MILLION IN THE YUKON TERRITORY,' THEN WE HAVE TO CONSIDER THAT SUCH CHARGES ARE NOT THOSE 'NORMALLY PAID BY NATURAL GAS PIPELINES IN CANADA IN ACCORDANCE WITH ACCEPTED REGULATORY PRACTICE,' AND THEREFORE, UNDER SECTION 12 OF THE AGREEMENT, ARE NOT TO BE PASSED THROUGH TO U.S. CONSUMERS. IN THE COURSE OF SUCH CONSULTATIONS, WE WOULD ALSO EXPECT TO CONTINUE TO TRY TO RESOLVE OUR DIFFERENCES IN CAPITAL COST ESTIMATES BETWEEN THE 54-INCH AND 56-INCH ALTERNATIVES, IN THE MANNER DESCRIBED ABOVE.

"AN ALTERNATIVE TO EITHER OF THE COURSES OF ACTION DISCUSSED ABOVE, WHICH HAS BEEN SUGGESTED TO US BY VARIOUS REPRESENTATIVES ON THE CANADIAN SIDE, WOULD BE TO REGRESS TO THE 54-INCH SYSTEM FOR THE WHITEHORSE-TO-CAROLINE SEGMENT, IN ORDER TO AVOID EVEN A TECHNICAL CHANGE TO THE AGREEMENT. WE BELIEVE THAT THE CANADIAN SIDE SHARES OUR CONVICTION THAT THE 56-INCH SYSTEM IS SUPERIOR TO THE 54-INCH. CONSEQUENTLY, IT WOULD BE UNWARRANTED TO CHOOSE A LESS DESIRABLE ALTERNATIVE IN ORDER TO AVOID CHANGING THE AGREEMENT; THEREFORE, WE

ARE NOT PREPARED TO ACCEPT THE 54-INCH SYSTEM FOR THE SAME REASONS THE NATIONAL ENERGY BOARD REJECTED IT IN THEIR FEBRUARY 20 DECISION: POORER FUEL EFFICIENCY AND HIGHER COST OF SERVICE THAN THE 56-INCH SYSTEM.

"WE HOPE THAT OUR PROPOSED ADDENDUM RELATING TO FOOTHILLS' MARCH 3 FIGURES WILL BE SATISFACTORY TO YOU. WE FEEL THAT THIS APPROACH WOULD PROVIDE QUICK RESOLUTION ON CONFIDENTIAL

CONFIDENTIAL

PAGE 03 OTTAWA 01232 03 OF 03 110030Z

THIS MATTER AND PROVIDE AN ADEQUATE SOLUTION TO BOTH OF OUR PROBLEMS, GIVEN THE DE MINIMUS SCALE OF OUR DIFFERENCES COMPARED TO THE TOTAL SIZE OF THE PROJECT. WE LOOK FORWARD TO A FAVORABLE RESPONSE TO OUR PROPOSAL.

"SINCERELY, DON E. SMITH"

ENCLOSURE: "PROPOSED ADDENDUM TO ANNEX III OF THE AGREEMENT ON PRINCIPLES APPLICABLE TO A NORTHERN NATURAL GAS PIPELINE

THE CAPITAL COSTS SPECIFIED IN ANNEX III INCLUDE ALL NORMAL PIPELINE COSTS INCURRED ON CONSTRUCTING GAS PIPELINE FACILITIES IN CANADA, EXCEPT THOSE SPECIFICALLY EXCLUDED IN THE PROVISIONS OF THE ANNEX, AND INCLUDE SUCH ITEMS AS AN ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION AS WELL AS AN ALLOWANCE ON AND RECOVERY OF REGULATORY MONITORING COSTS, PROVIDED THAT REGULATORY . MONITORING CHARGES SHALL NOT EXCEED 0.7 PERCENT OF THE ESTIMATED FIXED CAPITAL COSTS." ENDERS

CONFIDENTIAL

NNN

Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: COSTS, PETROLEUM PIPELINES, PUBLIC CORRESPONDENCE
Control Number: n/a
Copy: SINGLE
Draft Date: 10 mar 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978OTTAWA01232
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780108-1071
Format: TEL
From: OTTAWA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780382/aaaacrru.tel
Line Count: 366
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 36a2acc9-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 7
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 78 STATE 60183, 78 STATE 62084
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 08 jul 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3373213
Secure: OPEN
Status: NATIVE
Subject: CAPITAL COST OF NORTHERN GAS PIPELINE
TAGS: ENRG, CA
To: STATE
Type: TE
vdkgvwkey: odhc://SAS/SAS.dbo.SAS_Docs/36a2acc9-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014